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ANNUAL REPORT

MARCH 20

1966

THE HAMILTON COTTON COMPANY, LIMITED

The Hamilton Cotton Company, Limited

AND SUBSIDIARY COMPANIES

Head Office: 304 MARY STREET, HAMILTON, ONTARIO

Plants at:

Hamilton, Ontario - Trenton, Ontario - Dundas, Ontario - Ajax, Ontario

Marysville, New Brunswick

Sales Offices at:

Halifax - Montreal - Toronto - Hamilton - Winnipeg - Vancouver

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Directors

Alan V. Young
William H. Young
Dunlop Stewart
S. B. Stewart
E. G. Howe
James M. Young
David M. Young
R. N. Steiner
L. S. Magor

Officers

Alan V. Young
Chairman of the Board

William H. Young
President and General Manager

S. B. Stewart
Vice-President

D. M. Young
Vice-President

J. M. Young
Vice-President

G. B. Lawrence
Vice-President—Manufacturing

G. H. Pullam
Vice-President and General Sales Manager

E. G. Howe
Vice-President and Secretary-Treasurer

AUDITORS

Peat, Marwick, Mitchell & Co.

REGISTRAR, TRANSFER AGENT AND TRUSTEE FOR BONDHOLDERS

Canada Permanent Trust Company
Toronto, Ontario

BANKERS

Canadian Imperial Bank of Commerce

Annual Report of Directors

To the Shareholders:

Your directors submit herewith the thirty-eighth annual report of your Company including the consolidated balance sheet as of 20th March, 1966, and the statements of profit and loss and surplus for the period ended on that date. The fiscal year end having been changed from December to March, this report covers 16 four week periods.

FINANCIAL

Consolidated net profit for the fiscal year ended March 20th, 1966, was $58,175 after depreciation of $518,355. Textile profits were comparable for the fiscal year but these were offset by the heavy loss of the machinery division of The P. B. Yates Machine Company Limited which is consolidated in the profit figure.

Working capital at $1,846,321 was a reduction of $835,878 from the figure of $2,682,199 at the end of previous year.

Capital expenditures totalled $1,504,948 which were partially financed by the decrease in working capital; partially by an increase of $608,946 in notes payable and conditional sales contracts not due in one year; and partially by the use of previous advances of $604,661 to Drei-S GmbH for the purchase of certain of its fixed assets as reported hereunder. The present level of working capital is unsatisfactory. However, factors that have adversely affected it in recent years will change during the present fiscal year. The four year term of the two large leasebacks of fixed assets undertaken in 1962 terminate by October 1966, which reduces rental payments by $480,000 per year. The program requiring large expenditures on fixed assets in the past two years will be completed in 1966 and so capital expenditures in the present fiscal year will be very much less than in 1965. The heavy loss of the machinery division of the P. B. Yates Machine Company which was an unexpected drain of working capital during the past year will be reduced, although not eliminated in the year. It is not until 1967 that projected figures on cash flow show a major improvement in your Company's working capital position.

An independent appraisal of the current market values of your Company's textile fixed assets made in late 1965 totalled $8,710,000 more than the net value of these assets on your Company's books. It has been Company practice to depreciate machinery and equipment at 10% of original cost per year. As the appraisal showed this rate to have been more than adequate to reflect the decreasing market value of machinery and equipment installed in the past, your directors adopted a new annual depreciation rate, effective during the past year, of 7½% of original cost for these classes of assets. Values of machinery and equipment acquired in the past years were adjusted on the Company books to this change in depreciation rate. As a result, the sum of $614,000 was added to earned surplus from the depreciation reserve. No change was made in the depreciation rate for buildings which remains at 5% of original cost per year.

Your directors deemed it prudent to write down the book value of certain investments and advances to realistic values based on present circumstances. Such write-downs resulted in a decrease in earned surplus of $442,026.

TEXTILE OPERATIONS

Demand for your Company's textile products was strong throughout the year. Costs and production suffered through a severe shortage of labour at all plant locations, particularly to fill the off-hour shifts which are essential to a profitable operation. Sales again made a new high and profit remained stable.

Capital expenditures for textile fixed assets amounted to $879,369. In the past five years your Company has acquired the use of approximately $4,500,000 of textile fixed assets by purchase or by leasing. Fixed assets acquired by leasing do not show on the balance sheet until the purchase option at the end of the main lease term is exercised and title to the asset is obtained by your Company at a low cost.

Union contracts at Hamilton, Dundas and Trenton plants terminated in July, 1966, and negotiations for their renewal are now in progress.

THE P. B. YATES MACHINE COMPANY LIMITED

The machinery divisions of this company suffered a heavy loss. This was due partially to the costs of consolidation and reorganization of new product lines being greater than anticipated. Mainly it was due to sales being less than forecast and costs more than budgeted.

A program of major retrenchment is currently under way which will result in a large reduction in the Yates machinery loss in 1966 with the target of a profitable operation in 1967.

NORTH AMERICA BUSINESS EQUIPMENT LIMITED—(NABEL)

NABEL experienced a year of profitable growth in 1965. However, since the collapse of Atlantic Acceptance Company Limited last summer it has been difficult for finance companies to borrow money and these conditions require NABEL to limit the new business it can accept. While this will adversely affect NABEL's growth and profit during 1966 the company has increased rates and reduced expenses and has a sound base from which to renew its upward trend when debt financing becomes more readily available.

For its fiscal year ended June 30th, 1965, NABEL reported a profit available to the common shareholders of $164,000. The Hamilton Cotton Company owns 70,000 common shares of NABEL's presently outstanding 190,000 common shares at a cost of $267,626 and it owns 10,000 of NABEL's 21,000 outstanding 5% non-cumulative, redeemable, preference shares of $50.00 par value, which are each convertible into ten NABEL common shares at any time. The Hamilton Cotton Company Limited has also advanced $550,000 to NABEL on a secured note.

HAMILTON LEASING LIMITED

This leasing company operating in the United Kingdom and Ireland continued its profitable rate of growth. Unaudited figures for Hamilton Leasing's fiscal year ended 30th May, 1966, show a net profit of £95,000 (approximately $285,000 Canadian). After payment of preferred dividends the increase in common share equity was approximately £65,000 ($195,000 Canadian). The Hamilton Cotton Company Limited owns 35% of the common shares of Hamilton Leasing at a cost of $112,157 and NABEL owns a further 12½%. The Hamilton Cotton Company also owns £200,000 of 6% preference shares upon which dividends are being paid. These dividends are included in the Hamilton Cotton Company profit and loss figures for the year. Hamilton Leasing Limited is also limiting its new business because of the difficulty of raising new funds.

MASCHINEN MIETE GMBH

This leasing company, which operates in West Germany, continued to grow profitably. For its fiscal year ended November 30th, 1965, it showed an increase in common share equity of 62,000 D.M. (approximately $16,800 Canadian), and for the six months to May 31st, 1966, a further increase of 197,000 D.M.

The Hamilton Cotton Company Limited owns 45% of the common shares of Maschinen Miete at a cost of $108,547 and NABEL owns a further 10%.

Maschinen Miete, similar to NABEL in Canada, must temporarily limit its rate of growth to that which it can finance from its own cash flow because of present tight money in Germany. Alternatively additional shareholders must be found who will provide the necessary funds to permit Maschinen Miete to sustain its present growth rate, in which case your Company will have a reduction in its percentage holding of Maschinen Miete common shares.

OTHER LEASING COMPANIES

Your Comany also has share interests in leasing companies operating in France, Belgium and Spain. All these companies are now profitable and well established with their growth only restricted by their ability to borrow funds. In each the majority interest is held by local residents or institutions who have undertaken to find the necessary funds. As these companies grow the percentage interest of The Hamilton Cotton Company may decrease as new sources of capital purchase equity as well as providing funds on loans.

DREI-S GMBH

During the year your Company sold its shareholding in Drei-S GmbH and severed its connection with the company. At that time your Company purchased certain of the machinery and equipment and lease-hold improvements belonging to

Drei-S GmbH, paid for in part by cancelling its demand note to The Hamilton Cotton Company Limited. Part of this machinery is being leased back to Drei-S GmbH, and the remainder, in seven shops where the lease-hold improvements were also acquired, is now being operated by a wholly-owned subsidiary, Hamilton Cotton GmbH, which commenced operations since March 20th, 1966.

TECHNAMATION (EUROPE) S.A.

This Belgium company owns the continental European rights to the patented "technamation" processes, developed by Technical Animations Incorporated of Port Washington, New York, by which an appearance of animation is imparted to still pictures through techniques using light polarization. The future of this company is largely dependent on interesting marketing developments now taking place in the United States which, if successful, can be applied to Europe. In the past year Technamation (Europe) lost approximately $25,000—most of it in market development expense which was fully written off. Your Company owns all the shares in Technamation (Europe), although 50% of them are under option to Technical Animations Inc. until August, 1967.

PROSPECTS

Strong demand for textile products has prevailed for over four years, the longest upswing in the traditional textile business cycle since the end of World War II, and there is no apparent sign of a downturn. The demands on the United States textile industry of the military requirements of the Viet Nam war has created a shortage of supply in the normal textile markets in that country. When the U.S. textile industry is busy so is the Canadian industry as normally much of the Canadian market is supplied by U.S. textile production but the percentage decreases when U.S. capacity is fully occupied at home. 1966 should be another year in which the textile sales of your Company will be limited only by its capacity to produce.

The leasing companies in which your Company now has a sizeable investment and which (apart from NABEL) it was instrumental in forming and developing over the past four years, are now well established and profitable. A shortage of capital in all countries is presently restricting growth but leasing has now become an accepted and growing method of financing the acquisition of capital assets throughout Europe as well as in North America. The companies in which your Company has an interest seem assured of future profit growth when capital again becomes more readily available.

Your directors wish to express their continued and sincere appreciation for the co-operation of all members of the staff.

By order of the Board of Directors.

W. H. Young,

President.

The Hamilton Cotton Company, Limited

MARCH 20, 1966, WITH COMPARAT

Assets

Current assets:	1966	1964
Notes and accounts receivable, trade	$ 2,224,564	2,405,190
Other accounts receivable (including $10,144 from a director)	62,975	42,992
Other notes receivable	842,080	....
Amounts receivable from subsidiary not consolidated	30,000	177,626
Inventories, at lower of cost or net realizable value:		
Cotton divisions	4,136,295	4,364,366
Machine divisions	1,461,873	1,498,023
Prepaid expenses	98,023	112,269
Deposits with mutual fire insurance company . .	46,702	60,233
Total current assets	8,902,512	8,660,699
Conditional sales contracts, not due within one year .	89,196	197,761
Mortgages receivable (including employees $14,890) .	46,170	55,377
Investment in and advances to subsidiaries not consolidated:		
Investment in shares *(note 2)*	65,521	195,590
Advances	17,828	552,027
Other investments and advances:		
Investment in shares of associated company *(note 2)*	171,397	473,053
Other investment in shares *(note 2)*	1,815,705	864,752
Advances	49,597	691,492
Fixed assets *(note 3)*:		
Buildings, machinery and equipment	12,454,590	11,161,112
Less accumulated depreciation	8,011,193	8,202,779
	4,443,397	2,958,333
Land	199,554	203,554
	4,642,951	3,161,887
Deferred development and other charges, at cost less amounts written off	105,196	42,031
Excess of cost of investment in consolidated subsidiaries over the equity therein at dates of acquisition . .	15,201	17,217
	$15,921,274	14,911,886

Approved on behalf of the Board:

ALAN V. YOUNG, *Director.*
W. H. YOUNG, *Director.*

See accompanying note

Subject to the accompanying report of Peat, Marwick, M

AUDITORS' REPORT

We have examined the consolidated balance sheet of The Hamilton consolidated statements of profit and loss and earned surplus for the peri general review of the accounting procedures and such tests of accountin circumstances.

In our opinion, the accompanying consolidated balance sheet and consolid position of the company and subsidiaries at March 20, 1966, and the results in accordance with generally accepted accounting principles which, except on a basis consistent with that of the preceding year. Also, in our opinion presents fairly the information shown therein.

Hamilton, Ontario.
July 19, 1966.

Subsidiary Companies Consolidated Balance Sheet

FIGURES FOR DECEMBER 27, 1964

Liabilities

	1966	*1964*
Due to banks, secured by assignment of book debts and merchandise:		
Demand loans	$ 4,471,500	1,917,425
Current account	110,396	49,100
	4,581,896	1,966,525
Notes and accounts payable and accrued expenses ($106,944 secured by equipment and $893,512 secured by raw cotton)	2,310,131	3,850,878
Deposits on contracts	38,863	46,386
Contribution to pension and retirement funds . .	20,858	62,150
Income taxes payable	26,714	6,911
Other taxes payable	73,615	41,536
Dividends payable	4,114	4,114
Total current liabilities	7,056,191	5,978,500
Notes not due within one year	547,211	252,991
Conditional sales contract secured by new machinery acquisitions	314,726	....
Funded debt *(note 4)*	2,200,000	2,350,000
Deferred credits:		
Income taxes *(note 5)*	92,000	143,000
From sale of fixed assets *(note 6)*	739,590	1,272,272
Finance charges	28,206	45,353
Shareholders' equity *(note 7)*:		
5% cumulative redeemable sinking fund preferred shares of $100 par value each. Authorized and issued 3,691 shares less 400 shares redeemed in 1964	329,100	329,100
Common shares of no par value. Authorized 200,000 shares; issued 80,000 shares . .	1,200,000	1,200,000
Contributed surplus, unchanged during the period .	166,005	166,005
Reserve for contingencies, unchanged during the period	450,000	450,000
Earned surplus *(note 8)*	2,798,245	2,724,665
Total shareholders' equity	4,943,350	4,869,770
Contingent liabilities and commitments *(note 10)*		
	$15,921,274	14,911,886

consolidated financial statement.

ell & Co., Chartered Accountants, dated July 19, 1966.

IE SHAREHOLDERS

ton Company, Limited, and subsidiaries, as of March 20, 1966, and the rom December 27, 1964, to March 20, 1966. Our examination included a cords and other supporting evidence as we considered necessary in the

statements of profit and loss and earned surplus present fairly the financial heir operations for the period from December 27, 1964, to March 20, 1966, he matter referred to in note 3, have been applied in all material respects accompanying consolidated statement of source and application of funds

PEAT, MARWICK, MITCHELL & CO.
Chartered Accountants.

Consolidated Statement of Profit and Loss

For the Period December 27, 1964 to March 20, 1966

(With Comparative Figures for the Year Ended December 27, 1964)

	1966	*1964*
Net sales	$22,538,883	17,111,786
Profit from operations before the undernoted items and after providing depreciation $518,355 (1964 $579,291) and remuneration of directors, including salaries of officers who are directors, $133,481 (1964 $122,200)	$ 226,052	673,730
Increase in equity of an associated company	....	99,864
Increase (decrease) in equity of a subsidiary company not consolidated	2,898	(7,977)
Increase in equity of other investments	69,446	....
Dividends ($114,000 from subsidiary not consolidated)	168,217	36,023
Other investment income	150,685	191,053
Gain (loss) on sales of fixed assets	(11,956)	30,667
	605,342	1,023,360
Deduct:		
Interest on funded debt	167,581	145,493
Other interest	401,710	263,653
Pension and retirement plan contributions	13,376	62,150
	582,667	471,296
Profit before income taxes	22,675	552,064
Income taxes:		
Deferred recovered *(note 5)*	(51,000)	....
Less current	15,500	33,896
	(35,500)	33,896
Net income	$ 58,175	518,168

See accompanying notes to consolidated financial statement.

Subject to the accompanying report of Peat, Marwick, Mitchell & Co., Chartered Accountants, dated July 19, 1966.

Consolidated Statement of Earned Surplus

For the Period December 27, 1964 to March 20, 1966

(With Comparative Figures for the Year Ended December 27, 1964)

	1966	1964
Amount at beginning of period	$ 2,724,665	2,376,356
Add:		
Net income	58,175	518,168
Adjustment of prior years depreciation *(note 3)* .	614,000	....
	3,396,840	2,894,524
Deduct:		
Dividends:		
Preferred	20,569	16,955
Common	136,000	80,000
	156,569	96,955
Adjustment of prior years income taxes, including deferred income taxes, $52,800	....	72,904
Write-down of investments	442,026	....
	598,595	169,859
Amount at end of period	$ 2,798,245	2,724,665

See accompanying notes to consolidated financial statement.

Subject to the accompanying report of Peat, Marwick, Mitchell & Co., Chartered Accountants, dated July 19, 1966.

Notes to Consolidated Financial Statement

March 20, 1966

1. The consolidated financial statement includes the accounts of the company, all but one of its domestic subsidiaries and one foreign subsidiary. The accounts of one minor subsidiary have been included on the basis of a financial statement dated December 26, 1965.

   The accounts of the domestic subsidiary and the two foreign subsidiaries not consolidated have been excluded because of the different nature of their businesses.

2. The investment in the domestic subsidiary not consolidated, acquired at a cost of $100, is stated at the net underlying asset value of $9,690, an increase of $2,898 since December 27, 1964. The investment in the foreign subsidiaries not consolidated, acquired at a cost of $110,477, is stated at $55,831 which is greater by $6,603 than the net underlying asset value. No provision has been made for this difference.

   The investment in shares of the associated company, acquired at a cost of $28,392 is stated at the net underlying asset value of $171,397, a decrease of $301,656 since December 27, 1964, charged to earned surplus.

   The investment in other shares, acquired at a cost of $1,746,260 is stated as:

At cost	$1,634,102
At net underlying asset value	181,603
	$1,815,705

3. Fixed assets are stated at values as appraised in 1928 with subsequent additions at cost.

   Because of current values of textile machinery and a revision of its estimated remaining useful life the accumulated depreciation thereon at December 27, 1964, has been restated to reflect lower rates of annual depreciation prior to that date resulting in a credit to earned surplus of $614,000. The effect of this transfer on income taxes recorded in those prior years has not been recorded. The lower rates of depreciation so determined were used in the current period. Had the previous rate been used a net loss of approximately $140,000 would have resulted.

4. Funded debt consists of:

	1966	1964
6% First Mortgage sinking fund bonds due April 1, 1972 of which $125,000 are required to be retired by way of sinking fund by April 1 in each year to 1971	$1,250,000	1,375,000
6¼% Sinking Fund debentures Series A due August 1, 1983 of which $25,000 are required to be retired by way of sinking fund by August 1 in each year to 1982	950,000	975,000
	$2,200,000	2,350,000

   The bonds and debentures may be retired for other than sinking fund purposes, at the company's option, at premiums varying according to date of redemption.

5. The accumulated excess of depreciation claimed for tax purposes over the amounts recorded was reduced in the current period with a consequent reduction in deferred income taxes applicable to future years. This reduction of $51,000 has been credited to consolidated income.

6. The deferred credit from sale of fixed assets arose in prior years on sale and lease-back transactions and is being credited to income over the initial terms of the leases.

   The aggregate rentals paid in the current period for the use of land, buildings and equipment under the sale and lease-back arrangements and leases amounted to $1,153,556. The minimum annual rentals to be paid in the fiscal years ending in March 1967 and 1968 amount to $752,585 and $387,503 respectively reducing thereafter in varying amounts to $73,000 payable in 1989.

7. The preferred shares are redeemable at $101 plus accrued and unpaid dividends. The company is required to provide $15,000 (or less in certain circumstances) annually for the redemption of preferred shares which provision was fulfilled in 1964 for the current year.

   Series A warrants, issued with the 6¼% Sinking fund debentures, Series A, entitle the holders thereof to purchase an aggregate of 8,000 common shares up to and including July 2, 1972 at prices varying from $25 to $35 per share depending on date of purchase. 8,000 common shares have been reserved for issuance on the exercise of the warrants.

8. Under the provisions of Section 61 of the Canada Corporations Act $40,000 of earned surplus is restricted as representing the amount of preferred shares redeemed. The Trust Deeds securing the funded debt contain restrictions on the payment of dividends if certain conditions are not met.

9. Assets and liabilities originating in foreign currencies have been translated on the following bases: Current items at the rate of exchange in effect at March 20, 1966; other items at the rates in effect at the dates the transactions were completed.

10. Contingent liabilities:

    As guarantor of bank loans of a supplier, $1,495,000 U.S. (secured by raw cotton warehouse receipts in the Southern United States) and others, $102,576

    As guarantor of a mortgage, $350,000

    For notes receivable sold with recourse, $350,403

    Commitments for the purchase of fixed assets were approximately $130,000 at March 20, 1966.

Consolidated Statement of Source and Application of Funds

PERIOD FROM DECEMBER 27, 1964 TO MARCH 20, 1966

FUNDS PROVIDED:			
Decrease in conditional sales contracts receivable		....	$ 108,565
Decrease in mortgages receivable		....	9,207
Decrease in investments and advances:			
Subsidiaries not consolidated		$ 664,268	....
Less increase in other investments and advances		7,402	....
		656,866	....
Deduct decreases charged to earned		....	....
surplus	$442,026		
Less increases in equity recorded	72,344	369,682	287,184
Proceeds from sale of fixed assets		....	107,573
Decrease in excess of cost of investment of consolidated subsidiaries over the equity therein		....	2,016
Increase in notes not due within a year		....	294,220
Increase in conditional sales contracts payable		....	314,726
			1,123,491
USED AS FOLLOWS:			
In operations:			
Non-cash items entering into net income:			
Transfer of deferred gain on sale of fixed assets		532,682	....
Decrease in deferred income taxes		51,000	....
Increase in equity in subsidiary and other investments		72,344	....
		656,026	
Deduct:			
Depreciation	$518,355		
Loss on sale of fixed assets	11,956	530,311	
Non-cash items, net		125,715	
Deduct net income		58,175	
Cash loss from operations		67,540	
Purchase of fixed assets		1,504,948	
Increase in deferred development and other charges, net		63,165	
Reduction of funded debt		150,000	
Reduction of deferred finance charges		17,147	
Dividends paid		156,569	1,959,369
Decrease in working capital			$ 835,878

Working capital changes:

	March 20, 1966	December 27, 1964	Increase (Decrease)
Current assets	$8,902,512	8,660,699	241,813
Current liabilities	$7,056,191	5,978,500	1,077,691
	$1,846,321	2,682,199	(835,878)